

Fiscal Services Division
Legislative Services Agency
Fiscal Note

SF 128 as amended by S-3066 - Cigarette/Tobacco Tax Increases (LSB 1023 SV.1)

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Fiscal Note Version – As Amended by S-3066

Requested by Senator Matt McCoy

Description

Senate File 128, as amended by S-3066, increases the cigarette tax rate from \$0.36 per pack of 20 cigarettes to \$1.36 per pack and increases the tobacco tax rate from 22.0% of the wholesale cost to 50.0% of the wholesale cost. Premium cigars are taxed at 22.0% with an additional tax of 28.0% or \$0.50 per cigar, whichever is less. The Bill as amended also provides that tax receipts are appropriated from the General Fund to a Health Care Trust Fund beginning July 1, 2007.

Background

The cigarette tax was last increased in 1991 when it was raised from \$0.31 per pack to the current rate of \$0.36 per pack. The tobacco tax was also increased that year, moving from 19.0% to 22.0% of the wholesale price.

Under current law, the Revenue Estimating Conference (REC) projects gross cigarette tax revenues to be \$89.5 million in FY 2008 and \$90.4 million in FY 2009. Gross tobacco tax receipts are projected to be \$9.7 million in FY 2008 and \$10.0 million in FY 2009. Receipts from cigarette and tobacco tax are currently deposited in the General Fund.

Assumptions

Cigarette Tax:

- The retail price of a pack of cigarettes is \$3.64.
- Iowa currently loses about 8.8% of cigarette tax revenue due to various types of evasion. The rate of tax evasion following the rate change is assumed to equal 18.35%.
- Based on research, a \$1.00 per pack (27.5%) increase in price has an elasticity equal to negative 0.7. Overall demand due to the tax increase is estimated to decrease by 19.2%.
- Preemptive buying equal to 21.5% of normal purchases is assumed to occur over the month and a half preceding the rate change and offsetting reductions in purchases are spread over six months following the rate change. Although this Bill is effective upon enactment, preemptive buying is still expected to occur prior to the tax increase.
- The assumed effective date for the rate change is April 1, 2007.
- Fiscal Year 2009 cigarette demand is assumed to decline by 1.0% from the previous year (prior to the tax change).
- The increase in the cost of cigarettes will have a higher negative impact on the sale of cigarettes in Iowa border communities.

Tobacco Tax:

- Assumes the same assumptions used for cigarettes in regards to tax evasion and early purchasing rates due to an increase in tax.
- A retail margin of 20.0% over the wholesale price is assumed for tobacco products (other than cigarettes).
- The demand price elasticity assumed for a tax rate change from 22.0% to 50.0% of the wholesale price (equivalent to a 23.0% retail price increase) equals negative 0.67. Overall demand due to the tax increase is estimated to decrease 15.4%.
- The assumed effective date for the rate change is April 1, 2007.
- Assumes the pre-tax increase on premium cigars accounts for 15.0% of tobacco tax receipts.
- Premium cigars with a wholesale cost of more than \$1.80 per cigar will have a maximum tax of \$0.90 per cigar.

Sales Tax (State, Local Option Sales Tax (LOST), and School Infrastructure Local Option Sales Tax (SILO):

- Due to the cigarette/tobacco tax increase, demand is estimated to decrease nearly 20.0% from the pre-tax increase projections. However, the overall sales taxable cost of the products is increasing, offsetting much of the decreased demand.
- Tax evasion is estimated at 8.8%.
- Statewide, the percent of local option sales tax (LOST) is assumed to remain at the FY 2006 level of 0.69% and the School Infrastructure Local Option Sales Tax (SILO) is assumed to remain at 0.95%.

FY 2007 General Fund and Health Care Trust Fund:

- Cigarette and Tobacco tax receipts will be deposited in the General Fund. Beginning in FY 2008, the first \$127.6 million of cigarette and tobacco tax receipts will be appropriated annually to the Health Care Trust Fund. Changes to the General Fund are based on FY 2007 and FY 2008 REC projections for Cigarette and Tobacco taxes. Impacts on the General Fund in FY 2009 assume a 1.0% decrease from FY 2008 REC projections for the cigarette tax and a 2.1% increase for the tobacco tax.

Section 1 of SF 128 increases the minimum amount a retailer can charge for cigarettes from 6.0% to 8.0% of the basic cost of cigarettes. Section 2 increases the minimum amount a wholesaler can charge for cigarettes from 3.0% to 4.0% of the basic cost of cigarettes. Although these sections may have an impact on State sales tax, local option sales tax (LOST), and school infrastructure local option sales tax (SILO), that amount is unknown and not addressed in this fiscal note.

Fiscal Impact

Overall impacts to the cigarette tax, tobacco tax, sales tax (including Local Option Sales Tax (LOST) and School Infrastructure Local Option (SILO) Sales tax), General Fund, and Health Care Trust (HCT) Fund are provided below.

Cigarette Tax Impact:

Cigarette tax receipts will increase above current REC estimates. The receipts will be divided between the General Fund and the Health Care Trust (HCT) Fund. The overall impact in revenues generated from the increase in the cigarette tax is an additional \$32.7 million in FY 2007, \$129.4 million in FY 2008, and \$134.0 million in FY 2009 (see table below).

FY 2007			
	Estimated FY07 Current Law	Estimated FY07 SF 128	Estimated Impact FY07
Cigarette Tax	\$ 89,500,000	\$ 122,177,539	\$ 32,677,539
FY 2008			
	Estimated FY08 Current Law	Estimated FY08 SF 128	Estimated Impact FY08
Cigarette Tax	\$ 90,400,000	\$ 219,838,524	\$ 129,438,524
FY 2009			
	Estimated FY09 Current Law	Estimated FY09 SF 128	Estimated Impact FY09
Cigarette Tax	\$ 89,500,000	\$ 223,508,669	\$ 134,008,669

Tobacco Tax Impact:

Tobacco tax receipts will increase above current REC estimates. The receipts will be divided between the General Fund and the Health Care Trust (HCT) Fund. The overall impact in revenues generated from the increase in the tobacco tax is an additional \$1.9 million in FY 2007, \$5.4 million in FY 2008, and \$5.7 million in FY 2009.

FY 2007			
	Estimated FY07 Current Law	Estimated FY07 SF 128	Estimated Impact FY07
Tobacco Tax	\$ 9,700,000	\$ 11,619,830	\$ 1,919,830
FY 2008			
	Estimated FY08 Current Law	Estimated FY08 SF 128	Estimated Impact FY08
Tobacco Tax	\$ 10,000,000	\$ 15,352,332	\$ 5,352,332
FY 2009			
	Estimated FY09 Current Law	Estimated FY09 SF 128	Estimated Impact FY09
Tobacco Tax	\$ 10,210,000	\$ 15,867,486	\$ 5,657,486

Sales Tax Impact:

The estimated change in the State sales tax revenue will impact the General Fund. The amounts displayed for LOST and SILO represent statewide totals. The overall impact of the state sales tax (\$0.05 rate) is an increase of \$0.8 million in FY 2007, a decrease of \$0.5 million in FY 2008, and a decrease of \$0.5 million in FY 2009.

	<u>FY07</u>	<u>FY08</u>	<u>FY09</u>
Estimated Change in Sales Tax (General Fund Revenue)	\$ 831,435	\$ - 539,878	\$ - 462,545
Estimated Change in Local Option Sales Tax (LOST)	\$ 114,738	\$ - 74,503	\$ - 63,831
Estimated Change in School Infrastructure Local Option Sales Tax (SILO)	\$ 157,973	\$ - 102,577	\$ - 87,883

Overall General Fund Impact:

The estimated gross impact to the General Fund will be an increase of \$35.4 million in FY07, \$134.3 million in FY 08, and \$139.2 million in FY 2009.

As amended, SF 128 appropriates increased cigarette and tobacco tax revenue from the General Fund to the Health Care Trust Fund as provided in the next table.

Overall Health Care Trust (HCT) Fund Impact:

Senate File 128, as amended by S-3066 as amended provides that beginning in FY 2008, the first \$127.6 million from the cigarette and tobacco tax be annually appropriated to the Health Care Trust Fund (HCTF).

Estimated Health Care Trust Fund (HCT) Impact				
	Estimated HCT Fund FY07	Estimated HCT Fund FY08	Estimated HCT Fund FY09	
Amount Appropriated to HCTF	\$ 0	\$ 127,600,000	\$ 127,600,000	

Sources

Iowa Department of Revenue
Revenue Estimating Conference Tax Receipt Projections
Campaign for Tobacco Free Kids, *State Cigarette Prices, Taxes, and Costs per Pack*
LSA Calculations

/s/ Holly M. Lyons

March 7, 2007

The fiscal note and correctional impact statement for this bill was prepared pursuant to Joint Rule 17 and pursuant to Section 2.56, Code of Iowa. Data used in developing this fiscal note and correctional impact statement are available from the Fiscal Services Division, Legislative Services Agency to members of the Legislature upon request.
